Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

COMMENTS OF THE
NATIONAL EXCHANGE CARRIER ASSOCIATION, INC. [1]

The Federal-State Joint Board on Universal Service has requested comment on four proposals to modify the Commission's rules relating to high-cost universal service support, submitted by Joint Board members and staff in the context of the above-captioned proceeding.[2] The Joint Board also asks interested parties to supplement the record with any additional issues or facts that have been raised since the comment cycle closed on the Joint-Board's August, 2004 Public Notice seeking comment on various "basis of support" issues in this proceeding.[3]

[1] The National Exchange Carrier Association, Inc. (NECA) is a non-stock, non-profit association formed in 1983 pursuant to the Commission's Part 69 access charge rules. *See generally* 47 C.F.R. 69.600 *et seq*. NECA is responsible for filing interstate access tariffs and administering associated revenue pools on behalf of incumbent local exchange carriers (ILECs) that choose to participate in these arrangements. NECA is also responsible for collecting high cost loop data from its member companies pursuant to part 36 of the Commission's rules. *See* 47 C.F.R. §36.611-613.

[2] Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules relating to High-Cost Universal Service Support, CC Docket No. 96-45, *Public Notice,* FCC 05J-1 (rel. Aug. 17, 2005)(*Request for Comments*). The proposals are entitled "The State Allocation Mechanism: A Universal Service Reform Package" by Joint Board Member Ray Baum; "Three Stage Package for Universal Service Reform," by Joint Board Member Billy Jack Gregg; "A Holistically Integrated Package (HIP)," by Former Michigan PUC Commissioner Robert Nelson; and a "Universal Service Endpoint Reform Plan (USERP)," proposed by state staffers Joel Shifman, Peter Bluhm and Jeff Pursley.

[3] *Id.* at ¶ 1; Federal-State Joint Board Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support, *Public Notice*, CC Docket No. 96-45, 19 FCC Rcd 16083 (2004) (*2004 Public Notice*).

The Commission and the Joint Board have been presented with a number of difficult and complex issues in this phase of the Commission's universal service reform proceeding. The state members of the Joint Board, the Consumer Advocate, and staff members are to be commended for their efforts to develop alternative solutions that appear to recognize the need to compensate carriers for the costs of providing service in high-cost areas and to target support effectively.

The four proposals differ in a number of respects – how to determine carrier costs, how a benchmark rate should be determined, transition plans, *etc.*, but have in common the concept of a State Allocation Mechanism, or "SAM." Under this approach, universal service high cost funding amounts for eligible telecommunications carriers (ETCs) would initially be determined pursuant to FCC rules, but amounts otherwise payable to ETCs in a state would be subject to allocation by the state PUC.[4] According to the plans' proponents, this approach would allow agencies with direct responsibility over end-user rates (generally, state public utility commissions or "PUCs") to determine which ETCs, study areas or even exchanges are most in need of universal service support within their jurisdiction.[5] The plans also generally permit, but do not require, states to develop their own supplemental universal service funding mechanisms.

In comments filed earlier in this proceeding, NECA and many other commenters pointed out that use of alternative costing methods, such as forward-looking "proxy" models, would cause universal service support payments to become disconnected from

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[4] *See, e.g., Request for Comments* at 3,12-13,15 & 20.

[5] *See id. at* 12, 15 & 20.

booked costs of ILECs.[6] Existing account-based methods, in NECA's experience, provide the most reliable way to determine and to verify the actual costs incurred by companies to serve high cost, rural areas.[7]

The four proposals described in the *Request for Comments* recognize the value of using embedded costs to determine support amounts for rate-of-return carriers.[8] The proposals also recognize that current mechanisms are limited to particular categories of costs (*i.e.*, loop plant and switching) and may not adequately capture other factors, such as long transport routes, that make some rural areas exceptionally costly to serve. In this regard the plans appear to recognize the need to maintain a connection between the costs of serving a particular area and support payments.

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[6] NECA Comments, Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (Oct. 15, 2004) at 13-14 (*NECA's Oct. 15, 2004 Comments)*; NTCA Comments, CC Docket No. 96-45 (Oct. 15, 2004) at 2-3; USTA Reply Comments, CC Docket No. 96-45 (Dec. 14, 2004) at 8-9; ITTA Reply Comments, CC Docket No. 96-45 (Dec. 14, 2004) at 4-5.

[7] NECA and other parties in this proceeding have also pointed out that it would be premature in any event for the Joint Board to recommend alternative forward-looking model-based support mechanisms because the existing model used to determine support for non-rural companies has been shown not to work for rural companies. *See id.* More than five years have elapsed since the Rural Task Force issued findings to the effect that the existing Synthesis Model is not workable for rural areas, yet no concrete proposals have been advanced as to how this or any other model can be adapted in such a way as to target support accurately in these critical areas. *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256,* 16 FCC Rcd 11244 (2001) at ¶ 4.

[8] *See, e.g., Request for Comments* at 21. At least one proposal suggests that support to CETCs should be based on embedded costs as well. *Id.* at 10. ("Basing embedded cost support on each carrier's own costs would prevent potential windfalls to competitive ETCs with lower cost structures than incumbents"). Commissioner Baum notes that embedded costs may also form the basis of a cost proxy model, and points to existing average schedule settlement formulas as an example of such a model. *Id.* at 4. Average schedule formulas may not be effective, however, for companies that face extremely high costs—in most cases, such companies have elected to perform cost studies precisely because average schedule formulas do not work well in estimating costs in such circumstances.

This connection would be lost, however, to the extent states allocate cost-based support based on non-cost factors.[9] Moreover, paying some companies less support than is needed (as determined by available cost measures), and others more, appears fundamentally at odds with existing rate-of-return regulation principles as well as the Act's requirement that universal service support be "specific, predictable and sufficient."[10]

On the other hand, to the extent the proposals contemplate use of cost-based factors to allocate support at the state level, it would seem simpler, and more direct, to apply such factors solely at the federal level based on federal rules. This would help assure that universal service support continues to comply with the Act's policy directives, and avoid the complexity and uncertainties associated with varying – and potentially controversial – allocations performed by fifty different jurisdictions.

The proposals also contemplate combining existing local switching support (LSS) and interstate common line support (ICLS) with high-cost loop support.[11] Although intended to simplify existing mechanisms, the use of a hybrid mechanism could produce unintended results. It should be kept in mind that existing LSS and ICLS mechanisms were intended to moderate interstate access rates in rural and high-cost areas, not local

[9] State allocations of federal funds could be "discretionary." *See, e.g., Request for Comments* at 24-25 ("States could assign support to particular carriers, study areas or exchanges. They could also condition support funds on particular uses, such as requiring the carrier to meet broadband deployment targets in particular exchanges.")

[10] 47 U.S.C. § 254(b)(5). The proposals may also raise questions as to whether the Commission may delegate its authority over universal service support fund management to the states in the manner contemplated by the proposals. *See United States Telephone Association v. FCC,* 359 F3d 554, 565-68 (D.C. Cir. 2004)(holding that the FCC may not sub-delegate its decision making authority to outside entities absent statutory authority).

[11] *Request for Comments* at 10, 17 and 21.

service rates. As such these support programs are functionally integrated with interstate access tariffs, and represent a key component of interstate access cost recovery.

ICLS, for example, was created to offset reductions in interstate carrier common line revenues for rate-of-return carriers.[12] The LSS component of the Commission's federal universal service program is intended to provide additional support to small telephone companies who tend to incur disproportionately high local switching costs.[13] LSS amounts are determined based on a fraction of costs allocated to the interstate jurisdiction in excess of relative interstate usage. These amounts are recovered from the federal universal service fund, with the remainder recovered via interstate local switching access rates.[14] It is unclear from the various proposals how combining these two funds with high cost loop support, and then reallocating those amounts based on cost or non-cost based analyses of local service conditions, would enable better targeting overall of federal universal service support or permit companies to recover their interstate access costs, which are currently recovered through ICLS and LSS.

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[12] ICLS is computed by calculating the interstate common line revenue requirement for each study area and then subtracting study area revenues obtained from end user common line charges, special access surcharges, and certain non-analog line port costs. The residual amount is paid as ICLS from existing federal universal service funds. 47 C.F.R. § 54.901(a).

[13] 47 C.F.R. § 36.125.

[14] In 2002 the Line Port component of local switching revenue requirement was reassigned to the Common Line category, and is now recovered through common line-related charges. *See, e.g.*, 2003 NECA Modification of Average Schedule Formulas, WC Docket No. 03-9 (Dec. 31, 2002), at VII-52. The Commission modified the access rate structure for rate-of return carriers by reallocating line port costs from local switching to the common line category in the 2001 MAG Order. Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, Federal State Joint Board on Universal Service, CC Docket No. 96-45, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-return Regulation, CC Docket No. 98-77, Prescribing the Authorized Rate-of-return for Interstate Services of Local Exchange Carriers, CC Docket No. 98-166, *Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166*, 16 FCC Rcd 19613 at ¶90 (2001)(*MAG Order*).

Other specific suggestions advanced in the four proposals have been examined in prior phases of this proceeding. In its *2004 Public Notice*, for example, the Joint Board sought comment on proposals that would combine study areas in a state for purposes of determining federal support levels. As several parties in that proceeding pointed out, however, proposals to force study area consolidations among affiliated companies assume a benefit from economies of scale that may not always be present. Many commonly-owned study areas within a state are separated by long distances and rugged terrain, and operate substantially in stand-alone fashion. It is thus not clear whether it makes economic sense to treat companies in this situation as if they were one study area.

The proposals also appear aimed at controlling growth in high cost funding.[15] In its comments submitted in response to the *2004 Public Notice*, NECA reported data showing that the majority of the fund growth at that time could not be attributed to increases in costs among rural rate-of-return ILECs but were instead associated with growth in payments to CETCs.[16]

Current data show this trend has continued. In 2005, high cost fund levels have grown by 6%. During that period, overall ILEC support levels have declined by 1.6%.[17] Among rural rate-of-return ILECs, costs grew in the past year, but only by about 1 percent. In contrast, high cost support amounts to rural CETCs increased by over 50% in 2005. The net effect is that every "new" dollar in USF support – and then some – is

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[15] "Every dollar given to one ETC would be a dollar that could not be given to another." *Request for Comments* at 4; "Use of the model for larger carriers should reduce the total amount of high cost support…" *Id.* at 9; "Combining study areas and existing programs in a holistic manner allows each state to better control the growth in the total USF." *Id.* at 17.

[16] *NECA's Oct. 15, 2004 Comments* at 11.

[17] In the fourth quarter of 2004, ILECs received $818 million in support, while in the fourth quarter of 2005, that amount will decline to $805 million. *Compare* USAC Appendix HC-01, August 2004 with USAC Appendix HC-01, August 2005. Annualized, rural rate-of-return ILECs' 2004 payments amounted to $3.272 billion in 2004 and $ 3.220 billion in 2005.

associated with growth in CETC payments, not growth in ILEC costs. To the extent that growth in the fund is a concern, therefore, it would appear that corrective efforts should be directed towards rationalizing CETC payment methodologies rather than making changes in existing ILEC support mechanisms.[18]

Conclusion

Proposals that permit state agencies to allocate federal high-cost support dollars at the state level, intended to improve targeting of universal service funding, may raise serious concerns. To the extent that state allocations are based on non-cost factors, existing rate-of-return regulatory structures and cost recovery could seriously be compromised. On the other hand, if cost-based factors are to be used, it would appear more direct, and simpler, to develop federal support rules that incorporate such factors at the beginning of the process. These would serve to target funding more accurately while assuring support distributions remain predictable and sufficient, as required by section 254 of the Act.

Other proposals, such as study area consolidations, that appear intended to limit or curtail support amounts payable to ILECs appear misdirected, in that there does not appear to be a rational basis for adopting these measures other than to control fund growth. Yet, as shown in recent data filings, recent growth in fund levels is attributable to CETC payments, not increases in ILEC costs. For these reasons NECA respectfully suggests that universal service reform efforts be directed towards finding ways to expand

[18] *See* Letter from Karen Brinkman, Latham & Watkins, LLP, Counsel for Midsize Representatives, to Marlene H. Dortch, FCC, CC Docket No. 96-45 (June 16, 2005) "Universal Service Fund increases not driven by 'new' support for rural companies," Stating that increased payments to RLECs in the High Cost fund is attributed to the substitution of access for ICLS, while CETC support is "growing unabated."

the contribution base for universal service programs and rationalizing support methodologies for competitive carriers.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the NECA's Comments was served this 30th day of September 2005, by electronic filing and e-mail, to the persons listed below.

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